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SUBJECT: Guangdong's High Tech Incentives Fall Short for Industrial Equipment Manufacturers

REF: A) Guangzhou 732, B) Guangzhou 228

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¶1. (U) Summary: Industrial equipment manufacturing (EM): with its high-tech, high-value-added, environmentally friendly, capital intensive and skill labor focus, it's just what Guangdong's leaders are looking for to replace labor-intensive export manufacturers that are being encouraged to move out of the Pearl River Delta (PRD). Plus EM is popular in the domestic market. However, EM business owners say they are feeling the negative effects of the economic downturn too. They report sales have dropped by as much as 70 percent and workforces have been cut by as much as 20 percent. To make matters worse, industry executives express frustration that government funds allocated as part of the recently announced stimulus package for high-tech companies in south China will not go to them but be soaked up by university-affiliated state-owned enterprises (SOEs). End Summary.

New Bird for the Empty Cage  
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¶2. (SBU) Industrial equipment manufacturing (EM) meets all the qualifications for the kind of high-tech and high value-added industries that Guangdong's leaders want to attract to the PRD as they encourage labor-intensive export manufacturers to move elsewhere -- a policy often referred to as "emptying the cage for a new bird." Gao Yunfeng, President of Hans Laser Technology Co., Ltd. explained to us that his 5,000 employee work force is highly educated, many of them holding college degrees including over 60 engineers holding masters or PhD degrees. The company has over 200 patents with technology that is more environmentally friendly than the labor-intensive manufacturing technology it replaces. He also said 90 percent of the company's laser machines are sold to China's domestic market for use in the production of electronics, appliances, computers, and textiles. Gao noted that his company enjoys gross profit margins of up to 50 percent, compared to the 10 percent margins seen in more labor-intensive industries.

¶3. (SBU) Daniel Yan, CEO and President of Interlume Laser Systems, said his target customers are U.S., European, and Taiwan companies based in China, especially "high-end" companies which are

"performance" not "price" sensitive. His company's ability to provide local, on-site, same-day service to customers is a key advantage over foreign-based competitors.

#### Suffering Too

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¶4. (SBU) Despite its advantages, the EM industry has been hit hard by the global financial crisis. Gao reported that Hans Laser suffered a 70 percent decrease in orders during the last quarter of 2008 and was forced to lay off 1,000 employees - 20 percent of its total workforce. Intelume executives say that in the short term, there is "essentially no business." Customers are not placing orders and are telling the firm to wait until after the Lunar New Year, said Yan.

¶5. (SBU) Some EM companies have been less affected by the downturn, but growth prospects have diminished. He Zhao, General Manager of Guangzhou Agile Manufacturing Technology Co. Ltd., said his firm had been growing through the fourth quarter of 2008, although the trend had slowed considerably. He claimed they hadn't had to lay off any workers yet but had reduced employee overtime hours. Comment: The uneven impact of the crisis on EM companies may be due to the different nature of Guangzhou Agile's products. Hans Laser and Intelume make production machines while Agile makes components for fixed-asset machinery. Since manufacturing companies are cutting costs, they may be less likely to procure new production machinery equipment. However, even as they scale back operations, manufacturers still require components for fixed-asset machinery to keep their workshops running. End Comment.

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#### Government's Empty Promises

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¶6. (SBU) In November, the Guangdong provincial government released stimulus package plans, which include over RMB 250 billion allocated to "industrial upgrading". The funds target high-tech projects, research and development in support of Guangdong Party Secretary Wang Yang's "double transfer" policy of moving labor-intensive factories and their migrant labor workforces out of the PRD (ref B). EM industry executives say they are aware of promised government funding for high-tech industries, but don't expect to receive assistance. The distribution of such government funding is not open or transparent enough, complained Gao. Distribution is decided by a group of so called "experts", who represent different interest groups, including universities, academic institutes and government officials. Usually the people who need the financial aid the most do not get it, Gao said.

¶7. (SBU) Gao said Hans Laser has applied in the past for government funds allocated to the hi-tech industry, but received very little compared to state-owned enterprises (SOEs), which benefit the most from the government's preferential policies. He explained that EM industry SOEs are established by quasi-governmental organizations and run by university professors, who benefit from tax rebates and profit from the enterprises and the patented technology. The SOEs can't compete on a level playing field because they are under the poor management of China's academic system, Gao explained. Comment: Gao's observations echo concerns we've heard from others in the PRD that SOEs will end up benefiting disproportionately from efforts to help firms weather the global economic downturn (ref A). End comment.

¶8. (SBU) Intelume's Yan said the most effective way to help hi-tech enterprises was through tax deduction, but he had not seen any government plans to reduce the tax burden. He commented that the government had the resources, but in the end the stimulus package would benefit construction companies, cement makers and the like. Most of these enterprises are controlled or held by the government, which means more opportunities for corruption, according to Yan.

¶9. (SBU) Comment: Similar to other sectors south China's economy, high-tech industries are also suffering the effects of the economic downturn. The government's explicit statements of support followed

by ambiguous actions are leaving many high-tech industry executives frustrated. Whatever the government's strategy may be, if their goal is to reassure industry and build confidence, it appears to be falling short. End Comment.

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